

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

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FISCAL IMPACT STATEMENT

LS 8139

BILL NUMBER: HB 1899

DATE PREPARED: Mar 1, 1999

BILL AMENDED: Feb 25, 1999

SUBJECT: Various tax and labor provisions.

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FUNDS AFFECTED: ☒ **GENERAL**
☒ **DEDICATED**
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) This bill makes the following provisions:

I. Health Insurance for Legislators: It allows members of the General Assembly to participate in:

- the self-insurance plan established by the state police department;
- any self-insurance plans established by the state; or
- a prepaid health care delivery plan established by the state.

It provides that a former member of the General Assembly who meets the criteria for participation in a group health insurance program provided to retired state employees or retired legislators may elect to participate in: (1) those group health insurance program; or (2) the self-insurance plan established by the State Police Department.

II. Common Construction Wage: This bill requires the committee that determines the common construction wage to determine a classification and skill level of labor to be employed on the project. It requires the committee to make wage determinations based on information presented at a public meeting and redefines the common construction wage.

The bill also provides that the common construction wage law does not apply to a new construction project that costs less than \$150,000 or a maintenance, remodel, or repair project that costs less than \$100,000.

III. Financial Institutions Tax: This bill treats resident financial institutions the same as nonresident financial institutions for purposes of the Financial Institutions Tax by providing that the tax is imposed upon the apportioned Indiana income of financial institutions. (Current law imposes the Financial Institutions Tax on the adjusted gross income of resident financial institutions.)

IV. Insurance Premium Tax: This bill phases in a reduced premiums tax rate to 1.75% and provides a credit against the Supplemental Net Income Tax (SNIT) based on retaliatory taxes paid.

V. Worker's Compensation: This bill increases the compensation benefits per degree of permanent partial impairment for worker's compensation through 2002. It also provides increases in the worker's compensation average weekly wage through 2001 and makes other changes concerning workers' compensation.

VI. Unemployment Compensation: This bill changes the base period for computation of unemployment benefits to the last four completed calendar quarters. (Current law provides that the base period for computation of unemployment benefits is the first four of the last five calendar quarters.) It phases in an increase to the earnings base used to compute unemployment compensation as follows:

- a maximum of \$7,200 in a calendar quarter beginning on and after July 1, 2000;
- a maximum of \$8,600 in a calendar quarter beginning on and after July 1, 2001; and
- a maximum of \$10,000 in a calendar quarter beginning on and after July 1, 2002.

(Current law provides that the earnings base used to compute unemployment compensation may not exceed \$5,800.)

The bill also provides that the maximum total amount of unemployment compensation benefits payable to an individual during any benefit period may not exceed 26 times the individual's weekly benefit, or 32% of the individual's wage credits with respect to the individual's base period, whichever is less. (Current law provides that the maximum total amount of unemployment compensation benefits payable to an individual during any benefit period may not exceed 26 times the individual's weekly benefit, or 28% of the individual's wage credits with respect to the individual's base period, whichever is less.) It decreases the minimum wage credit necessary to qualify for unemployment compensation to \$2,000 in the base period, and requires the total wage credits in the base period to equal at least 1.25 times the wages paid in the highest quarter. (Current law requires \$2,750 in the base period with \$1,650 in the last two quarters of the base period, and requires the total wage credits in the base period to equal or exceed 1.25 times the wages in the highest quarter.)

In addition, the bill allows the Worker's Compensation Board to perform an assessment at a rate not to exceed 3% and allows the Board to perform an assessment whenever necessary to ensure the continuation of compensation to fund beneficiaries. Increases the award period from 150 to 156 weeks.

VII. Mutual Insurance Holding Companies: This bill authorizes a mutual insurance company (MIC) to reorganize as a mutual insurance holding company (MIHC) with one or more subsidiaries. It establishes principles for the protection of the surplus of an MIHC for the exclusive benefit of its members and authorizes the formation of stock insurance company subsidiaries and intermediate stock holding companies as subsidiaries of an MIHC.

The bill also establishes requirements that any plan of reorganization or initial plan to issue stock must meet, including requirements that the plan be filed before July 1, 2001, that public hearings be held, and that the members of an MIC vote in favor of the plan after notice. It establishes certain requirements applying to mutual insurance holding companies, including the requirement to file annual reports with the insurance commissioner. An MIHC and its subsidiaries and affiliates would further be prohibited from taking certain actions, including the payment of special compensation to an officer or director for services associated with a stock offering.

Effective Date: January 1, 1999 (retroactive); July 1, 1999; January 1, 2000.

Explanation of State Expenditures: (Revised) ***I. Health Insurance for Legislators:*** This bill provides that current and former members of the General Assembly that meet certain requirements may choose to obtain health insurance coverage under the self-insurance plan established by the State Police Department or the State Personnel Department or through a prepaid health care delivery plan. At this time, there are 86 current members of the House and 34 current members of the Senate participating in the state employee health benefit plans. (The number of retired legislators participating in the state employee plans is not determined at this time.) For legislators who would choose to switch from a state employee indemnity insurance plan to the State Police health plan, the additional cost to the state currently is \$40.56 per year per employee. [If the opportunity to participate in the State Police health insurance plan provided sufficient incentive for a current legislator who is not currently on the state employee health plans to, now, participate in the State Police plan, the cost to the state would be \$2,216 (single plan) to \$5,495 (family plan) per legislator.]

Ultimately, the additional cost to the state will depend upon how many current legislators would choose to participate in the State Police health plan. (Retired employees are currently required to pay the entire cost of their health insurance premium, so there would be no direct impact on state costs.)

II. Common Construction Wage: This bill redefines the common construction wage and makes the following changes to the current wage determination process:

- A committee would be required to determine a scale of wages based on two skill levels (skilled labor and apprentice labor) for each classification of labor to be performed. Current law requires three classes (skilled, semiskilled, and unskilled labor) to be considered instead of the two levels proposed in this bill. The bill also includes a definition of “apprentice”.
- Current wages established through collective bargaining agreements in the county and survey data from the US Department of Labor would be specifically included as required evidence in the wage determination process.
- If a common construction wage committee is required, the committee must meet weekly at a regular time and public place to conduct its business.
- The scale of wages determined must include reasonable costs for training and basic health and pension benefits.
- The common construction wage law would not apply to new construction projects costing less than \$150,000 and to maintenance, remodeling, or repair projects costing less than \$100,000 (Current law states that common construction wage provisions do not apply to all projects costing less than \$150,000.)

Certain provisions of this bill reflect current practice in the construction industry and may not have a significant potential impact. Others, such as the provision requiring the consideration of health care and training costs, may alter the wage determination process and affect labor costs as a result. The influence of these changes is expected to vary from project to project, however, a number of studies suggest that wage determination provisions generally increase the labor cost of public works projects from 5% to 16%. The precise impact of the changes made by this bill cannot be determined.

Some studies argue for prevailing wage-type systems on the grounds that they lead to greater efficiency, quality, and safety by providing for a stable, well trained labor force (benefits typically associated with union labor). If such benefits were realized, the state could realize savings in the long run. Unfortunately, data limitations and questionable methodology limit the conclusiveness of many studies on prevailing wage laws. The information in this fiscal note will be updated if a more precise estimate of the overall cost associated with this bill becomes available.

Under this bill, the state Department of Labor would be required to adopt rules for the implementation of the common construction wage. Any expenses associated with this rule-making could be absorbed within the Department's current budget.

Secondary impact: If, as studies have shown, common wage requirements increase the costs of labor to the state, then higher wages may have the following effects:

- State income tax collections could increase (assuming no decrease in employment levels), stimulating consumption and further increasing sales tax revenue;
- debt incurred to finance projects could increase due to higher project costs, requiring additional bonding or property taxes; and
- funds may be used that otherwise would have been available for other public works projects. Similarly, capital expenses could be greater, making less funding available for non-capital expenses in project budgets.

III. Financial Institutions Tax: The Department of Revenue will have some administrative expenses associated with changing tax forms, instructions and computer programs to implement this change. These expenses will be covered under their existing budget.

IV. Insurance Premium Tax: The Department of Revenue and the Department of Insurance will have some administrative expenses associated with making changes to tax forms, instructions, and computer programming.

V. Worker's Compensation: This bill makes several changes to worker's compensation and occupational disease law:

Permanent Partial Impairment: The bill increases the rates for calculating permanent partial impairment compensation under worker's compensation and occupational disease law. The rates traditionally vary depending on the degree of impairment resulting from the injury. A different set of rates each year for three years would be established by this proposal (see Table A below). The rates would be effective for injuries and disablement occurring after the date shown in each column.

TABLE A: Permanent Partial Impairment Rate Additions
(for worker's compensation and occupational disease)

Permanent Partial Impairment Degrees of Injury	Current (in statute)	Effective July 1, 1999 (in statute)	Effective July 1, 2000 (Proposed)	Effective July 1, 2001 (Proposed)	Effective July 1, 2002 (Proposed)
1 to 10	\$750	\$900	\$950	\$1,000	\$1,050
11 to 35	\$1,000	\$1,100	\$1,450	\$1,850	\$2,400
36 to 50	\$1,400	\$1,600	\$2,000	\$2,700	\$3,500
51 to 100	\$1,700	\$2,000	\$2,600	\$3,400	\$4,400

Average Weekly Wage: This bill also increases the average weekly wage, which is used in determining the payment for permanent partial impairment under worker's compensation and occupational disease law. This bill also increases the maximum average weekly wage used in the determination of compensation for temporary total disability, temporary partial disability, and total permanent disability (see Table B). Medical benefits are determined by the degree of impairment and are not based on the wage.

Maximum Compensation: The bill also increases the maximum compensation (exclusive of medical benefits) that may be paid for an injury under worker's compensation and occupational disease law. New maximum compensation limits are added for injuries occurring after July 1, 2001 and July 1, 2002 (see Table B below).

Table B: Average Weekly Wage and Maximum Compensation Additions
(for worker's compensation and occupational disease)

	Current (in statute)	Effective July 1, 1999 (in statute)	Effective July 1, 2000 (in statute)	Effective July 1, 2001 (Proposed)	Effective July 1, 2002 (Proposed)
Average Weekly Wages	\$702	\$732	\$762	\$807	\$840
Maximum Compensation	\$234,000	\$244,000	\$254,000	\$269,000	\$280,000

It is difficult to determine the potential cost of these changes. SEA 12 (ss) in 1997 included similar adjustments for three years of permanent partial impairment rate increases and four years of average weekly wage increases. An actuarial analysis of these changes was performed by the National Council on Compensation Insurance (NCCI). The results predicted annual increases in premium rates of 5.6%, 0.4%, 2.6%, and 0.3% beginning 7/1/1997 (however, the 1997 bill included numerous other provisions not in this proposal, and these other provisions could have contributed to cost increases).

Despite the NCCI's projections, actual premium rates effective 1/1/1997 through 1/1/1999 have actually declined by 1.4% (based on the advisory rate filed by the Indiana Compensation Rating Bureau). Compensation paid to state employees has also not increased drastically. Indemnity payments totaled approximately \$2.9 M in FY 1996, \$3.1 M in FY 1997, and \$3.4 in FY 1998.

The discrepancy between the NCCI's projections and the actual premium rate changes demonstrate the difficulty in estimating the impact of this type of proposal. It is not known at this time how the provisions of this bill will impact state compensation costs, although it is likely that there will eventually be an increase. It is also possible that the impact of this bill will be smaller than that of 1997's SEA 12 (ss). The information in this fiscal note will be updated when a reliable cost estimate becomes available.

Examination restriction: It provides that a representative of the employer or insurance carrier may not attend an examination or treatment of an injured employee without the written consent of the employee and the treating medical personnel. This provision would not have a fiscal impact.

Occupational Disease Second Injury Fund: The bill establishes the Occupational Disease Second Injury Fund (effective January 1, 2001) for supplemental compensation to employees disabled from occupational diseases whose benefits have otherwise been exhausted. This fund would be administered by the Worker's Compensation Board. The Board could incur additional administrative expenses associated with this proposal, however, these expenses could be absorbed given the Board's current budget and resources.

VI. Unemployment Compensation: Currently, the maximum wage credit is \$5,600 per quarter and will increase to \$5,800 on July 1, 1999. This bill increases the maximum wage credit per quarter to \$7,200 on July 1, 2000, \$8,600 on July 1, 2001, and \$10,000 on July 1, 2002. Wage credits are divided into two parts to determine the maximum weekly benefit amount. A different percentage of each part is taken and added together to equal the weekly maximum. For example, under current statute the maximum wage credit per quarter is \$5,600, \$2,000 is multiplied by 5% and \$3,600 is multiplied by 4% to determine the maximum weekly benefit available per recipient. Based on this formula, the maximum weekly benefit equals \$244 $(\$2,000 \times 5\% + \$3,600 \times 4\%)$. In 1998, \$262,897,270 in benefits was paid from the Unemployment Insurance Benefit Fund. As of December 7, 1998, the balance in the Unemployment Insurance Benefit Fund was \$1.4 billion.

With assistance from the Department of Workforce Development, the following table outlines the maximum weekly benefit and the fiscal impact on the Unemployment Insurance Benefit Fund when the maximum wage credit is increased:

<u>FISCAL YEAR</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Maximum Wage Credit	\$5,6000	\$5,800	\$7,200	\$8,600	\$10,000
Maximum Weekly Benefit	\$244	\$252	\$308	\$364	\$420
Maximum Impact on the Fund (Increase)		(\$5.5 M)	(\$32 M)	(\$22 M)	(\$15 M)

VII. Mutual Insurance Holding Companies: The Commissioner of Insurance may, at the expense of the insurance company involved, hire accountants, actuaries, attorneys, financial advisors, investment bankers, and other experts to assist the Department in fulfilling the requirements of this bill. The Commissioner may

require the responsible company to deposit funds with the Department in anticipation of these expenses.

Explanation of State Revenues: (Revised) ***II. Common Construction Wage:*** Increases in wage levels may influence income tax and sales tax revenues (see above Explanation of State Expenditures).

III. Financial Institutions Tax: This bill changes the way that Indiana domiciled companies are taxed under the FIT to only include their apportioned income on earnings made in the state. This bill would make the FIT apply to all financial institutions on the same base of Indiana receipts.

Under the current statute, there are two different formulas for calculating the FIT depending on where the financial institution is domiciled. For Indiana domiciled financial institutions, their tax base is calculated using their total income earned in and out of state. FIT allows a credit to be taken for taxes paid to other states. This was done to capture income earned in another state due to Indiana's application of "economic nexus" where another state would not tax that income because there was no "physical nexus." This is sometimes referred to as "no where income."

Currently, out of state domiciled financial institutions report only their Indiana income earned in the state and use a one factor apportionment formula of receipts attributable to Indiana versus total receipts.

Prior to June 1, 1997, banks were required to establish a holding company that was incorporated and domiciled in each state where business was conducted. These corporations were defined as "resident" taxpayers under the FIT. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal) authorized interstate mergers between banks beginning June 1, 1997 regardless of whether the transaction would be prohibited by state law. The Riegle-Neal Act gave states the right to opt out of this arrangement if they pass legislation prohibiting mergers with out-of-state banks before June 1, 1997. Indiana did not pass any legislation prohibiting mergers, therefore the Riegle-Neal Act now applies to all financial institutions operating in Indiana. With the advent of interstate banking, financial institutions who could not expand across state lines may now do so and some multi state holding companies are combining their operations into single state banks with multi-state branches.

In essence, the Riegle-Neal Act has given financial institutions an incentive to reorganize and change their corporate structure to benefit from greater administrative efficiencies. However, many of the larger banks have found that the rate of taxation for an Indiana resident taxpayer with all its consolidated subsidiaries is greater than it was before when under the former organizational structure only its Indiana holding company was taxed as an Indiana resident. This has caused a number of institutions to change their commercial domicile so that they are now taxed as a nonresident based only on their Indiana income.

An example of how the deregulation and reorganization of banks has affected their calculation of FIT follows:

Prior to deregulation: An Indiana domiciled company with a subsidiary in Illinois (IL) and Kentucky (KY) would calculate their adjusted gross income (AGI) and apportionment factor (factor) by in the following manner:

factor =
$$\frac{\text{All its IN parents receipts} + \text{Indiana share of its IL subsidiary} + \text{Indiana share of its KY subsidiary}}{\text{All its IN parents receipts} + \text{all its IL's subsidiary receipts} + \text{all its KY's subsidiary receipts}}$$

IN AGI x factor (< 100%) = Franchise Tax Income

Franchise Tax Income x FIT tax (8.5%) - taxes paid to other states

Scenario 1. After deregulation: If an Indiana domiciled company merged its Illinois (IL) and Kentucky (KY) subsidiaries into divisions the following calculations would be made:

factor = All its IN parents receipts + all its IL's branch receipts + all its KY's branch receipts = 100%
All its IN parents receipts + all its IL's branch receipts + all its KY's branch receipts

IN AGI x 100% factor = Franchise Tax Income

Franchise Tax Income x FIT tax (8.5%) - taxes paid to other states

Scenario 2. After deregulation: If an Indiana domiciled company changes its state of domicile to Illinois (IL) and merged its Indiana and Kentucky (KY) subsidiaries into divisions the following calculations would be made:

factor = Indiana branch receipts only + its IL's parent IN receipts + Indiana share of its KY branch
All its IN branch receipts + all its IL's parents receipts + all its KY's branch receipts

IN AGI x factor (< 100%) = Franchise Tax Income

Franchise Tax Income x FIT tax (8.5%) - taxes paid to other states

If a financial institution reorganized and maintained Indiana as their state of domicile, their apportionment factor would also increase and they would be subject to paying more FIT to Indiana. The credit paid to other states has not been enough of a factor to negate the increase in FIT liability. (For example the Illinois tax rate is 7.3%; Kentucky's tax rate is 1.1% of net capital; Wisconsin is at 7.9%.) This has caused a number of financial institutions to look into changing their state of domicile for the parent company in order to reduce their level of taxation.

According to the Department of Financial Institutions there were 155 state charter banks and savings and loans as of January 14, 1999. Thirty three banks have dissolved their state charter in the last two years. With 651 FIT filers in FY 97, these state charter banks make up 24% of the number of financial institutions in the state. After review of the 1997 FIT returns, the DOR has determined that many of the large national banks are already apportioning their Indiana income and reporting as nonresident banks. This may be reflective in the decrease in FIT revenue for FY 98 which was \$95.6 M in FY 98 in comparison to \$100.7 M in FY 97.

The fiscal impact of changing the base of adjusted gross income of financial institutions to include only their Indiana receipts will affect FIT revenue in two ways. First, if one assumes that any institution which can now change their state of domicile to reduce their tax liability will do so absent this bill, then this change will not affect that eventual revenue loss. The state will only lose revenue from those Indiana banks that have income earnings in states where they do not have a physical presence and now under this bill they would only have to report their Indiana receipts.

Secondly, this change will eliminate the state's ability to use economic nexus to tax "no where income." However under deregulation it appears that Indiana has already lost its ability to use economic nexus to tax "no where income" from the majority of financial institutions operating in Indiana and only those remaining state domicile banks are including this income in their base. This has created a disadvantage for Indiana

domiciled banks.

It is estimated that this change will result in a net revenue loss of less than \$5 M annually in FIT collections. This assumes that FIT collections will continue to be affected by deregulation absent this bill and the only additional loss of FIT would be from Indiana domicile banks who do not have enough of an incentive to change their state of domicile. This change applies to tax years beginning January 1, 1999 and will affect revenue collections beginning in FY 2000. FIT revenue is deposited in the General Fund.

IV. Insurance Premium Tax: The Insurance Premium Tax is assessed on gross premiums received on policies covering risks in the state of Indiana. The tax base is comprised of premiums written or renewed in the past year minus deductions of reinsurance premiums, dividends paid to resident insureds, and premiums returned. The tax rate is currently 2.0% of these net premiums. The tax is paid by all insurance companies doing business in Indiana, however, companies domiciled in Indiana may elect to pay the Corporate Gross Income Tax in lieu of the Premium Tax (domestic firms also must pay the Supplemental Net Income Tax, or SNIT). Revenue from the Premium Tax is deposited in the state General Fund.

Reducing the Premium Tax rate from 2.0% to 1.75% could affect revenues from the Insurance Premium Tax, the Gross Income Tax, and the SNIT as follows:

Insurance Premium Tax: A reduction in the Insurance Premium Tax rate may affect domestic insurance companies differently than out-of-state entities:

(1) *Effect on domestic companies:* Decreasing the Insurance Premium Tax rate by 12.5% would not simply reduce the amount of tax due on premiums written in Indiana by the same proportion. This is partly because domestic companies may elect to pay the Gross Income Tax in lieu of the Premium Tax. In fact, of the more than 130 insurance companies domiciled in Indiana, only 39 currently elect to pay the Insurance Premium Tax. Only about \$4,556,000 in premium taxes were paid by Indiana domiciled insurance companies in 1997. If the Premium Tax rate is lowered, more companies may find it advantageous to pay the Premium Tax, simultaneously reducing Gross Income Tax revenue.

(2) *Effect on insurance companies not domiciled in Indiana:* The impact on out-of-state insurance companies varies with each state of domicile. This is due to Indiana's retaliatory tax provision, which provides that premiums written in Indiana by a company not domiciled in Indiana are taxed at either Indiana's rate or the rate in that company's home state, whichever is higher. The varying effects of the retaliatory provision are outlined in the following paragraphs:

(a) *Rates of 2.0% and above:* Premium Tax revenue collected from companies domiciled in states with a rate of 2.0% or higher would not change, no matter how low Indiana's rate was set. Because of the retaliatory provision, Indiana would collect at the higher of the two rates, which would still be at least 2.0%.

(b) *Rates between 2.0% and 1.75%:* Under this bill, Indiana will lose some revenue from companies in states where the Premium Tax rate is below 2.0% but above 1.75%. North Carolina, for example, has a rate of 1.9%. Under current law, the tax on premiums written by North Carolina companies in Indiana would be assessed at 2.0%. After a change in Indiana's rate to 1.75%, taxes on North Carolina premiums would be collected at 1.9%, the higher of the two rates. The retaliatory provision mitigates the potential loss with companies from states with premium tax rates between 2.0% and 1.75%.

(c) *Rates below 1.75%:* For companies domiciled in states with rates below 1.75%, the effect would be to reduce taxes paid in Indiana by 12.5%. The highest rate that would be applied would now be 1.75%, not 2.0%.

Although the retaliatory provision mitigates the potential loss, Premium Tax revenue from out-of-state companies would likely decrease whenever the rate is lowered. The net effect depends greatly on the number of domestic companies that switch to pay the Premium Tax rather than the Gross Income Tax. The impact of the proposed rate change on Insurance Premium Tax revenue was estimated using a model that included retaliatory tax effects. Several important assumptions were made:

- Although this bill proposes a five year phase-in by reducing the rate by 0.05% each year until 2004, no growth rate was used in projected the annual impact. Impacts for each year were calculated using premiums written in 1997.
- Based on recently proposed or enacted legislation, changes in premium tax rates in neighboring states were incorporated in the model. The new rates that were applied were: 1.4% in Ohio; 1.5% in Kentucky; 1.5% in Illinois; other various reductions in Alabama, Colorado, Tennessee, and Washington DC. All other states were assumed to maintain the same rates imposed in 1997.
- The majority of Indiana domestic insurance companies do not pay the insurance Premium Tax. If the rate was lowered, some companies may elect to pay the Premium Tax. However, it was estimated that a 1.75% rate may not be sufficient for most companies to make this transition. For the estimates presented here, it was assumed that no additional companies would pay the Premium Tax.

Insurance Premium Tax: Following the above assumptions, the lowered Insurance Premium Tax rate (1.75% from 2.0%) results in an additional loss in Premium Tax revenue of about \$2 M each year (see table below):

FY	NEW RATE	TOTAL REDUCTION	TAX SAVINGS FOR INDIANA FIRMS
2000	1.95 %	(\$1,970,000)	\$114,000
2001	1.90 %	(\$3,950,000)	\$228,000
2002	1.85 %	(\$5,920,000)	\$342,000
2003	1.80 %	(\$7,880,000)	\$456,000
2004	1.75 %	(\$9,840,000)	\$570,000

For domestic firms, only companies currently paying the Premium Tax would be affected, and these firms would only see a minimal reduction in their Indiana Premium Tax liability. The remaining reduction in collections represents tax savings for out-of-state insurance companies (also a loss of retaliatory tax revenue for Indiana).

As stated above, this model includes proposed or enacted changes in other states. Because some states that previously had premium tax rates (or effective premium tax rates) above 2.0% and are instituting reductions, Indiana will lose some revenue unless the existing premium tax rate was increased. If

Indiana's rate remains at 2.0%, the already proposed or enacted reductions in Alabama, Colorado, Louisiana, Ohio, and Washington DC will generate a loss of \$2,900,000 in retaliatory tax revenues to Indiana. To account for this effect, this base amount was subtracted from the impacts shown in the table above.

Gross Income Tax: The Gross Income Tax is normally assessed on the total gross receipts of a corporation's transactions in Indiana. However, not all of the gross receipts of an insurance company are taxed under the Gross Income Tax. The tax rate is 1.2%, and revenue from this tax is deposited into the state General Fund.

Only 39 of the insurance companies domiciled in Indiana currently elect to pay the insurance Premium Tax. The remaining companies pay a total of approximately \$30 M in gross income taxes. If the Premium Tax is reduced, more companies will find it advantageous to pay the Premium Tax, reducing gross income tax revenue. In the model used for this analysis, however, no companies were projected to switch to the premiums tax.

Supplemental Net Income Tax: Supplemental Net Income Tax liability is specially calculated for domestic insurance companies. The tax base is the federal taxable income of the company adjusted by:

- (Step 1) Multiplying the federal taxable income by the ratio of premiums tax receipts from policies insuring persons or property in Indiana to total premiums receipts; and
- (Step 2) subtracting the company's Gross Income Tax liability or the gross premiums tax liability, depending on which one the company has elected to pay.

The adjusted tax base as calculated above would then be multiplied by the SNIT rate of 4.5% to determine tax liability. SNIT revenue is deposited in the state General Fund.

If an insurance company switched from paying the Premium Tax or Gross Income Tax to the other because the taxes due would be less, the amount that would be subtracted in Step 2 would be smaller, resulting in greater SNIT liability. The DOR estimates that in FY 1997, \$18.4 M in SNIT was paid by domestic life and property and casualty insurance companies.

If Indiana domiciled insurance companies continue to pay the same tax (either the Gross Income Tax or the Insurance Premium Tax) as they elected to pay in 1997, a reduction in the Premium Tax rate to 1.75% would generate SNIT savings for the premium tax payers only. Companies would not be able to deduct this net gain from their adjusted tax base (see Step 2 above), resulting in an annual increases of SNIT revenue equal to premium tax savings multiplied by 4.5% (see table below):

FY	NEW RATE	PREMIUM TAX SAVINGS	SNIT TAX REDUCTION
2000	1.95 %	\$114,000	\$5,130
2001	1.90 %	\$228,000	\$10,260
2002	1.85 %	\$342,000	\$15,390
2003	1.80 %	\$456,000	\$20,520
2004	1.75 %	\$570,000	\$25,650

Net impact: The table below summarizes the net annual impact based on 1997 data for life, property, and casualty insurance premiums upon full implementation of the Insurance Premium Tax rate reduction from 2.0% to 1.75%:

FY	NEW RATE	PREMIUM TAX IMPACT	SNIT TAX IMPACT	TAX IMPACT
2000	1.95 %	(\$1,970,000)	\$5,130	(\$1,964,870)
2001	1.90 %	(\$3,950,000)	\$10,260	(\$3,939,740)
2002	1.85 %	(\$5,920,000)	\$15,390	(\$5,904,610)
2003	1.80 %	(\$7,880,000)	\$20,520	(\$7,859,480)
2004	1.75 %	(\$9,840,000)	\$256,500	(\$9,583,500)

While out-of state firms may seem to benefit most from this proposal, it must be noted that reducing the Insurance Premium Tax will reduce the cost of doing business in other states for Indiana's domestic insurance companies. The total benefit to domestic companies as a result of a lower tax rate is not currently known, but it is expected to exceed the reductions in state General Fund revenue projected above.

Retaliatory Tax SNIT credit: This bill also provides a credit against SNIT liability for Indiana companies equal to a certain percentage of the retaliatory taxes paid to other states. As stated above, domestic life and property and casualty insurance companies paid \$18.4 M in SNIT in FY 1997. Based on a recent Purdue University study, insurance companies currently paid approximately \$38 M in retaliatory taxes in FY 97. Assuming constant levels of these taxes paid, the impact of the credit is as follows (see table below):

FY	Percent of Retaliatory Taxes Allowed	Credit as Calculated	Credit with Cap
2000	20%	\$7,600,000	\$7,600,000
2001	40%	\$15,200,000	\$15,200,000
2002	60%	\$22,800,000	\$18,400,000
2003	80%	\$30,400,000	\$18,400,000
2004	100%	\$38,000,000	\$18,400,000

It must also be noted that as Indiana's premium tax decreases from 2.0% to 1.75%, the amount of retaliatory taxes paid may fall (assuming domestic companies would continue to write premiums at current levels). Or, as the cost of writing premiums outside of Indiana decreases, companies may do more business in other states, increasing the amount of retaliatory taxes paid. Because of the difficulty in estimating this effect, the current level was used for this analysis. This fiscal note will be updated as additional information and more precise estimates become available.

NET IMPACT: The net impact of the insurance premium tax provisions, the Insurance Premium Tax reduction and the Retaliatory Tax SNIT credit, on the state General Fund is as follows (see table below):

FY	Premium Tax Impact	SNIT Credit Impact	Net General Fund Impact
2000	(\$1,965,000)	(\$7,600,000)	(\$9,565,000)
2001	(\$3,940,000)	(\$15,200,000)	(\$19,140,000)
2002	(\$5,905,000)	(\$18,400,000)	(\$24,305,000)
2003	(\$7,859,000)	(\$18,400,000)	(\$26,259,000)
2004	(\$9,584,000)	(\$18,400,000)	(\$27,984,000)

Secondary impact: If insurance companies remain and prosper in Indiana or if new business is attracted to the state, corporate and personal income tax revenues could increase.

V. Worker's Compensation: *Worker's Compensation Second Injury Fund:* This bill gives the Worker's Compensation Board the authority to order an assessment of insurance carriers of up to 3% of their total annual payout of compensation (excluding medical benefits). This money would then be deposited in the Worker's Compensation Second Injury Fund. Current law provides for an annual assessment at 1% and if the fund's balance exceeds \$500,000 on April 1 of any year, the assessment is suspended for the following year or until the balance falls below \$500,000. In FY 1998, the total assessment was \$1,353,732 and the amount of compensation paid out was \$1,719,652. The fund's balance as of June 30, 1998 was \$661,532.

The bill would also extend the benefits available from the Worker's Compensation Second Injury Fund to 156 weeks (as opposed to 150 weeks under current law).

Occupational Disease Second Injury Fund: This bill establishes the Occupational Disease Second Injury Fund. Under this proposal, insurance carriers would pay 1% of their total annual payout of compensation for disablement or death from occupational diseases into the Occupational Disease Second Injury Fund. If the balance of the fund exceeds \$500,000 on April 1 of any year, the 1% assessment will be suspended for the following year (or until the balance falls below \$500,000).

An employee may apply to the Worker's Compensation Board for continuation of coverage by drawing on the Occupational Disease Second Injury Fund. An employee may receive up to 66 2/3% of the average weekly wage at the time of disablement, which would be \$732 after the effective date of this bill (until July 1, 2000). However, the employee would be limited to the maximum compensation (\$244,000 after the effective date of this bill).

Explanation of Local Expenditures: (Revised) ***II. Common Construction Wage:*** Local units and school corporations could be affected by any changes in the common construction wage determination process (see above Explanation of State Expenditures).

Explanation of Local Revenues: (Revised) ***II. Common Construction Wage:*** Counties with local option income taxes may also experience some additional revenue if higher wages occur. (see above Explanation of State Expenditures).

III. Financial Institutions Tax: Local units of government receive a guarantee distribution of FIT revenue so there will not be any changes in local revenues.

IV. Insurance Premium Tax: If a lower Premium Tax rate helps Indiana's domestic insurance companies expand, corporate and personal income tax collections could be increased, benefitting counties with local option income taxes. In addition, if an insurance company relocated outside the state because of lower Premium Tax rates in other states relative to Indiana's 2.0% rate, local property tax burdens could be shifted to other taxpayers.

State Agencies Affected: Department of Revenue, Department of Insurance, Department of Personnel, State Police Department, Department of Labor; all.

Local Agencies Affected: Local units and school corporations.

Information Sources: Department of Revenue; Department of Insurance; Pete Rimsans, Director of Policy, Planning, and Performance, Wage and Hour Division, Department of Labor, (317) 233-9351; Charles Mazza, Department of Workforce Development, (317) 232-7460.